Testimony of
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EMBARQ

before the
Subcommittee on Telecommunications and the Internet
Energy and Commerce Committee
United States House of Representatives

Digital Future of the United States:
The Future of Telecommunications Competition
9:30 a.m., Tuesday, October 2
2123 Rayburn House Office Building
Washington, DC 20515

Mr. Chairman, Ranking Member Upton and members of the Subcommittee, thank you for the opportunity to testify today. I am Bill Cheek, President of Wholesale Markets for Embarq. Headquartered in Overland Park, Kansas, Embarq is a full-service communications provider delivering voice, Internet, wireless and entertainment products to about 6.5 million access lines in 18 states. We serve primarily rural communities, which typically have higher costs to serve, and we are always mindful of the role that robust communications networks play in enhancing rural economies.

Embarq was established 16 months ago when Sprint Nextel spun off its local exchange operations, and we have been operating independently since that time. It is also a privilege to testify on the same panel as my former chief executive, Mr. Gary Forsee. While we may now approach telecom policy from differing perspectives, we continue to enjoy a relationship of great mutual respect.

Competition & Innovation

We commend the Subcommittee for convening this hearing on the future of telecommunications competition. The vision of the 1996 Telecommunications Act, crafted by many members of this subcommittee, was to transform the telecommunications landscape into a dynamic, deregulated, competitive marketplace. As a result, over last 11 years, we've seen unprecedented waves of innovation and investment, albeit often not in the shape and form we anticipated.

Embarq entered the competitive landscape last year at a time when few recognized the value of our local telephone network as a strategic asset, especially as wireless customers were "cutting the cord," cable TV providers were expanding their voice offerings and basic telephone subscriptions were (and still are) declining at a rate of more than six percent per year. Since then, we have leveraged that asset through various investments and partnerships and made innovation, continued network investment and superior customer service the linchpins of our ongoing transformation as a company.

- Just last week, we began offering 10 Mbps broadband in Las Vegas by pushing more fiber into the network and using new technologies to boost the maximum bandwidth we can deliver to our customers, with plans to expand it other parts of the country.
- Shortly after our spin-off, we rolled out our SmartConnect phone, a dual-mode mobile handset which acts as a cordless WiFi phone in the home or office, and as a fully mobile wireless phone when customers are on the go.
- Every Embarq high-speed Internet customer gets a 25 gigabit virtual storage vault for music, video, photos, mail and other files that can be accessed from anywhere.
- Our VideoClicks service offers customized video-on-demand over the Internet with news, movies, music videos and other content – all free.
- And we have more innovative products in the pipeline that will ultimately allow communications and digital content to move seamlessly with our customers wherever they go.

I believe we've achieved some level of success, but the truth is that in today's competitive market, all these things are just table stakes. They are only the beginning.

Special Access

One particularly timely topic for this hearing is the call by some for the Federal Communications Commission (FCC) to reverse the trend of deregulation and re-impose price controls and other regulations on the market for special access.[1] While we fully

[1] Special access refers to high capacity connections that Embarq and others sell to wireless and long-distance carriers, to competitors and to large corporate and government buyers. Sometimes they are retail

appreciate and participated in the Commission's recent steps to refresh the record in its special access rulemaking, we find the prospect of re-regulating a market that was initially de-regulated eight years ago to be inconsistent with competitive conditions in the marketplace today.

To put the issue in perspective, about 71 percent of Embarq's special access revenues are still subject to price cap regulation because they are provided in geographic areas where the Commission has not found the indicia of competition under current law. At the same time, 75 percent of our special access lines are subject to either CLEC or cable competition, and in more densely populated low-cost markets we typically face five or more competitors. Also, more than 70 percent of our special access revenues come from sales to carriers that are at least twice our size, and in most cases they are six times our size or larger.

Increasingly, large buyers are putting their special access needs out for competitive bids, especially in the wireless backhaul markets, where Embarq bids against multiple competitors, all of whom can see our public price schedules and few of whom are regulated to the extent we are. Just this past month, we submitted competitive bids for two multi-million dollar wireless backhaul contracts in Nevada and the Carolinas. In both cases, more than a dozen competitors submitted bids.

Unfortunately, our most aggressive competitors aren't counted under the current competitive trigger analysis the FCC uses to determine when a particular geographic

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offerings, like those we sell to casinos in our largest market of Las Vegas, and sometimes they are wholesale offerings that form a part of another carrier's product, like the wires that connect wireless cell towers to the underlying phone and data networks. The designations you'll hear for different special access products, such as DS1, DS3 and OCn, generally correspond to various levels of bandwidth or capacity. For example, a DS1 line can carry about 24 simultaneous voice conversations, whereas a DS3 can carry about 672 and an OCn can carry orders of magnitude more.

market should be deregulated. The problem is that current rules only count competitors who physically collocate their equipment in the incumbent's central office. But many of the new generation of competitors – cable, fixed wireless and other new entrants – bypass Embarq's network altogether and are never included when competition is measured. Despite the FCC's recent invitation to refresh the record, our top cable and fixed wireless competitors did not file their data.

In fact, our own analysis indicates that at least one of our currently regulated markets would merit pricing flexibility and deregulation if all our competitors were counted, because we are in direct competition with a cable provider, a fixed wireless provider and a local electric utility that has entered the special access business in that city.

In August and September, Embarq filed substantial data with the FCC showing our special access competitive losses, as well as the continuing impact of price cap regulation on our rates. In fact, Embarq demonstrated that our DS1 channel terminations (often used to connect cell towers) are, on average, priced below the forward-looking economic cost of providing the service. Prices for our higher capacity DS3 services have declined 35% since deregulation in 2001. Just this year, to meet growing competitive threats, Embarq more than doubled fiber investment plans for wireless backhaul, even as our prices have generally held steady or declined in some cases.

As a predominantly rural carrier, Embarq faces additional challenges. Re-regulation advocates have pointed to their substantial costs in purchasing special access, but providers like Embarq also face substantial costs in providing it. The vast majority of special access involves dedicated infrastructure, which means that once we build that infrastructure, it can't be used for any other purpose, even if the buyer eventually switches to fixed wireless or provisions the special access himself. And costs are significantly higher when the connection stretches more than three miles from the central office, as is often the case in rural areas where Embarq primarily serves.

Perhaps most tellingly, a November 2006 study by the Government Accountability Office (GAO) found that since the beginning of deregulation, the average price per unit actually paid for special access has declined.[2] Ultimately, we believe that if the Commission were to take action in the special access rulemaking, a necessary prerequisite would be to close a gaping hole in the record by obtaining data from all the new competitors in our filings and those of other ILECs, and ensuring that services provided by such providers were considered in any eventual rule change.

Forbearance

On the question of regulatory forbearance, our chief concern is that once a market has become competitive and new entrants are strong and healthy, it is unfair to impose extensive economic regulations on just one provider, even if only by regulatory inertia, while others grow their share unburdened. Congress seemed to anticipate this danger and deliberately structured Section 10 so regulators would periodically reaffirm the public interest in maintaining economic regulations or otherwise pare them back.

Embarq filed for forbearance from regulation of high-capacity broadband services, a market where Embarq does not have market power. Moreover, competitors like Time Warner Telecom and Cox Communications are already in the top tier (numbers 4 and 5) of the national market for Ethernet, easily surpassing Embarq's share. Truth be told, there is little or no incumbent advantage when it comes to building a SONET ring

[2] Government Accountability Office, Report 07-80, (Nov. 2006), at page 32.

around a metro area or providing Ethernet services. Cities have done it. Independent firms have done it. These are generally build-to-order systems where numerous firms can compete in any region. We understand the concerns expressed by Subcommittee members about the importance of clarity when the FCC acts and avoiding premature deregulation. We only urge you to also consider the burden of over-regulating firms like ours long after the conditions to justify it have ceased to exist in the market.

Municipal Networks

Regarding municipal networks, the nexus between municipal networks and competition is actually the source of our concern on this issue. Many communities view municipal networks as a tool of economic development, especially where private sector networks are not available. In other cases, however, the local government has made itself a competitor against companies like Embarq who have already invested our own private capital. While our personal preference is to let each state decide its particular approach to municipal networks, we look forward to a productive dialogue with the members of this Subcommittee.

Internet Regulation

Finally, I'd be remiss if I didn't address the issue of Internet regulation, also referred to as "net neutrality" by some. This is an issue of tremendous concern because the future of our company is so tied to the capital intensive network investment needed to build the Next Generation Web.

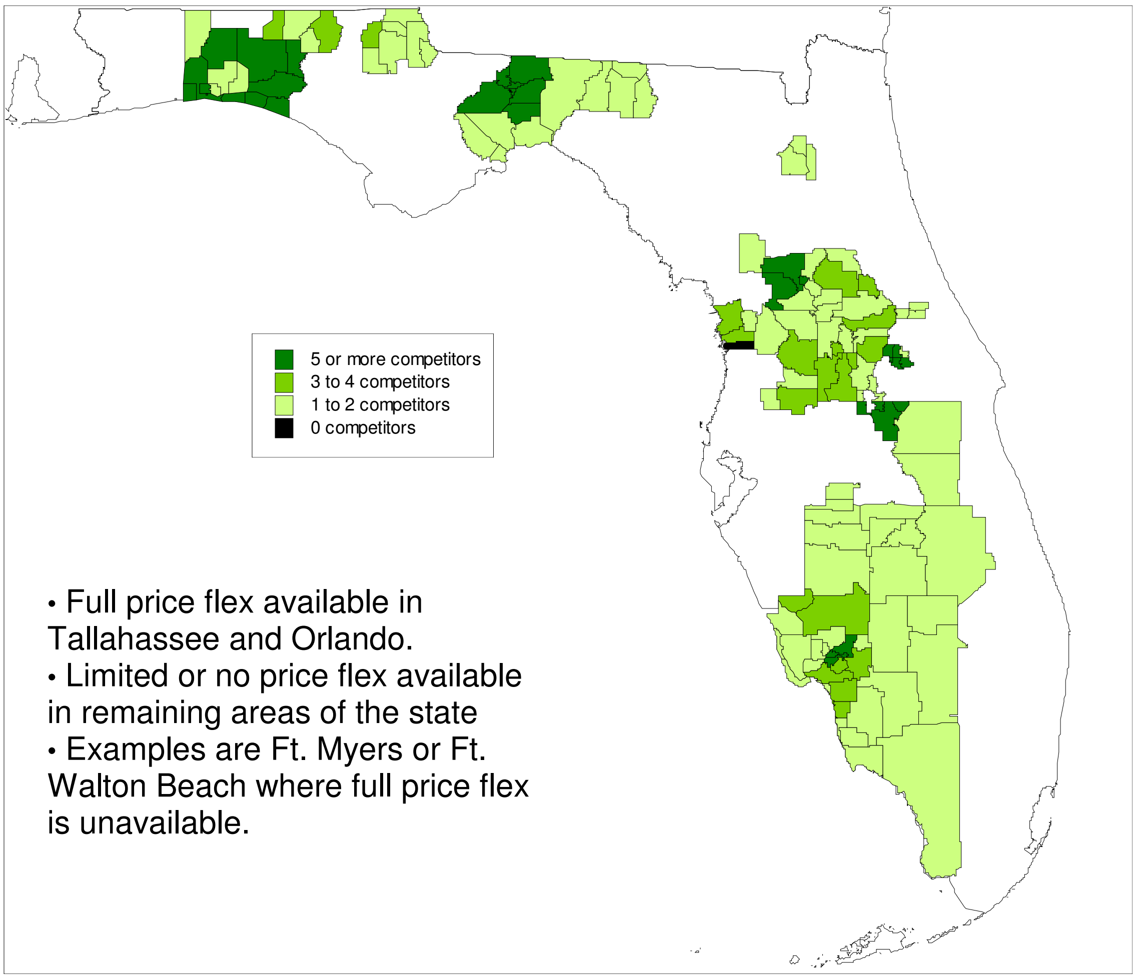
The Internet occupies an ever more central place in Americans' home and work lives. For example, online videos are supplanting traditional entertainment like cable and broadcast TV with dynamic video-on-demand options, more Americans are telecommuting and many consumers want to be ubiquitously connected. But keeping up with growing bandwidth demand requires tremendous network investment. Even a comparatively small company like ours has budgeted about $900 million in capital expenditures for 2007 to build out and upgrade the network.

Prescriptive network rules that substitute regulatory processes for engineering decisions are especially damaging for rural communities where the cost of network investment must be measured by the time it will take to recover it and eventually turn a profit. We understand policymakers have concerns about potential and alleged abuses, but the best way to balance competition concerns with investment incentives is to address each issue on a case by case basis and avoid additional unwarranted prescriptive rules.

Conclusion

Ultimately, we believe the best course for policymakers is to pursue a technology neutral approach that lets the market choose winners and losers, not government, and recognizes that competition often comes about in ways very different from how it was originally predicted. We thank you for the opportunity to appear and look forward to working with the members or this Subcommittee.

Competition Flourishes -- Embarq Wholesale Competitive Intensity - Florida
September 2007



• Full price flex available in Tallahassee and Orlando.
• Limited or no price flex available in remaining areas of the state
• Examples are Ft. Myers or Ft. Walton Beach where full price flex is unavailable.

<u>Wholesale Competitors</u>

Adelphia Business
Armstrong Utilities
AT&T Local Services
Brighthouse Networks
Charter
Comcast
Cox
Deltacom
FiberTower
Florida Digital Network
FPL Fibernet, LLC
Intermedia
Level 3 Communications
Mediacom
MFS Telecom
New Edge Networks
Newsouth
Smart City Solutions
Southern Light
Suddenlink
Time Warner
Time Warner Telecom
Tower Cloud
US LEC Corp
XO Communications